

**MEMO# 30901**

October 6, 2017

# **EU Commission Proposed Regulation to Reform the European System of Financial Supervision**

[30901]

October 6, 2017 TO: ICI Global Atlantic Chapter

ICI Global Brexit Task Force

ICI Global EU Capital Markets Union Task Force

ICI Global Exchange Traded Funds Committee

ICI Global Regulated Funds Committee

ICI Global Trading & Markets Committee

International Operations Advisory Committee

International Operations Working Group RE: EU Commission Proposed Regulation to Reform the European System of Financial Supervision

On 20 September 2017,[\[1\]](#) the European Commission (“the Commission”) proposed a package[\[2\]](#) of measures to revise the European System of Financial Supervision (ESFS),[\[3\]](#) including the role, competency, governance, funding and operation of the European Securities and Markets Authority (ESMA).[\[4\]](#) The proposed Regulation follows an earlier consultation by the Commission,[\[5\]](#) to which ICI Global responded.[\[6\]](#) Outlined below are those aspects of the proposed Regulation that are of relevance to regulated funds and their managers.

## **ESMA’s Competency to Opine on Delegation and Outsourcing Arrangements**

The Commission has proposed a strengthened role for the ESAs, including ESMA, to promote convergence in national competent authorities’ (NCAs) oversight of the delegation and outsourcing of activities by financial institutions, particularly to third country entities.[\[7\]](#) The proposal is designed to address regulatory arbitrage and financial stability risks that the Commission perceives to arise from variations in Member State approaches.[\[8\]](#) Of particular relevance to regulated funds and their managers, is a proposed new competency for ESMA to opine on outsourcing or delegation arrangements that concern a material part of a fund or manager’s activities. The proposed process through which ESMA would exercise this new competency is outlined below.

For new authorisations and registrations:[\[9\]](#)

## Action Timescale

1.

NCA notifies ESMA of its intention to authorise or register a fund or manager whose business plan entails “the outsourcing or delegation of a material part of its activities or any of the key functions or the risk transfer of a material part of its activities into third countries, to benefit from the EU passport while essentially performing substantial activities or functions outside the Union”. None specified beyond existing two and three month deadlines for UCITS[\[10\]](#) and AIFMs[\[11\]](#) respectively. 2. ESMA notifies the NCA of its intention to issue a non-compliance opinion. Within 20 working days of the notification in 1. 3. NCA is required to provide ESMA with information related to the authorisation or registration (on request). Within 15 working days of the notification in 2. 4. ESMA publishes its non-compliance opinion. Within 2 months of the notification in 1. 5. NCA either: (i) complies with ESMA’s opinion; or (ii) explains its reasons for non-compliance, which may be made public by ESMA[\[12\]](#) and supplemented by a formal opinion from the Commission.[\[13\]](#) Within 10 or 15 working days.[\[14\]](#) For existing funds and managers:[\[15\]](#)

**Action Timescale** 1. Fund or manager notifies its NCA of the outsourcing or delegation of a material part of its activities or any of its key function to another entity or its own branch established in a third country. None specified beyond existing requirements. 2. NCA informs ESMA of notifications made under 1. Semi-annually 3. NCA required to provide to ESMA with information on outsourcing and delegation arrangements by the fund or manager (on request). None specified 4. ESMA publishes recommendations to NCA, including concerning existing decisions or the withdraw of an authorisation None specified 5. NCA either: (i) complies with ESMA’s recommendation; or (ii) explains its reasons for non-compliance, which may be made public by ESMA[\[16\]](#) and supplemented by a formal opinion from the Commission. Within 15 working days.

## Supervisory Convergence and Coordination

The Commission has proposed general enhancements to ESMA’s supervisory convergence and coordination tools. These enhancements include the development of a three-year Strategic Supervisory Plan, which all NCAs will be required to implement through annual work programs,[\[17\]](#) and new independent reviews (replacing peer reviews), through which ESMA will assess the work of NCAs.

## ESMA’s Competency Concerning Other Regulated Entities

The Commission has proposed the transfer of competency from NCAs to ESMA for the authorisation and supervision of European venture capital funds (EuVECA),[\[18\]](#) European social entrepreneurship funds (EuSEF)[\[19\]](#) and European long-term investment funds (ELTIF).[\[20\]](#) In cases where the AuM of a EuVECA or EuSEF exceeds the de minimis thresholds specified under the AIFMD,[\[21\]](#) it is envisaged that ESMA will also assume competency for the supervision of the AIFM (as well as the fund), including ensuring the manager’s compliance with the national law implementing the AIFMD in the Member State of the manager’s establishment.[\[22\]](#)

Other aspects of the Commission’s proposed Regulation transfer to, or enhance competency of, ESMA in the following areas:

- Authorisation and supervision of data reporting service providers under MiFIR;[\[23\]](#)
- Authorisation and supervision of the administrators of critical benchmarks, and the recognition and endorsement of third country administrators and benchmarks,

respectively, under the Benchmark Regulation;[\[24\]](#)

- Supervision, including scrutiny and approval, and the processing of passport notifications, for certain types of prospectuses under the Prospectus Regulation;[\[25\]](#)
- Supervisory powers for Central Counterparties (CCPs), including enhanced competency for the recognition for third country CCPs;[\[26\]](#)
- Explicit application of MiFIR intervention powers to UCITS and AIF, where activities are carried out directly by UCITS and AIFMs;[\[27\]](#) and
- Requesting information directly from financial institutions, holding companies or branches of relevant financial institutions and non-regulated operational entities within a financial group or conglomerate;[\[28\]](#)

## **ESMA's Role in Respect of Third-Country Equivalence**

The Commission has proposed a stronger role for ESMA in respect of third-countries, including:

- Assisting the Commission in preparing equivalence decisions;
- Monitoring, on an on-going basis, regulatory and supervisory developments as well as enforcement practices in third countries;
- Submitting an annual confidential report on ESMA's findings from its monitoring of those third countries on which the Commission has taken an equivalence decision.

## **ESMA's Governance Arrangements**

The commission is proposing the creation of an Executive Board (EC) for each ESA, comprised of 5 full-time members in the case of ESMA. It is proposed that the EC will prepare decisions to be taken by the Board of Supervisors (BoS)[\[29\]](#) and, in turn, will take decisions in its own right by simple majority, with a casting vote for the chairperson, including in the following areas:[\[30\]](#)

- Matters of a non-regulatory nature including dispute settlements, breach of Union law matters and independent reviews;
- Setting out supervisory priorities for NCAs in the Strategic Supervisory plan;
- Check the consistency of NCAs' work programmes with EU priorities and review their implementation;
- Monitoring delegation, outsourcing and risk transfer arrangements to non-EU countries to ensure that inherent risks are addressed;
- Decide on stress tests and approaches to communication on the outcomes of stress tests.

The proposed EC for ESMA will consist of a Chairperson and 4 other full-time members, all of whom will be appointed for a 5-year term (renewable once) on the basis of an open call for candidates organised by the Commission, with final approval by the Council and European Parliament. EC members will be selected on the basis of merit, skills, knowledge of financial institutions and markets, and experience relevant to financial supervision and regulation. EC members are also expected to have extensive management experience.[\[31\]](#) EC members will be required to act independently and objectively in the sole interest of the Union as a whole and shall neither seek nor take instructions from the Union institutions or bodies, from any government of a Member State or from any other public or private body.[\[32\]](#) One member of the EC will also be appointed to assume the tasks of the current Executive Director, whose specific position will be eliminated.

## **ESMA's Funding**

The Commission is proposing a more diversified model of funding for the ESAs.[\[33\]](#) In the

case of ESMA, this includes replacing current mandatory contributions from NCAs with annual contributions from financial institutions that are indirectly supervised by ESMA, based on the estimated workload that is planned for each category of market participants. Financial institutions that are directly supervised by ESMA will continue to pay periodic fees (e.g. Credit Rating Agencies and Trade Repositories).

## Next Steps

The Commission's proposal will now be discussed by the European Parliament and the Council of the EU.

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### endnotes

[1] Proposed ESA Regulation, available from [https://ec.europa.eu/info/law/better-regulation/initiative/113085/attachment/090166e5b5347354\\_en](https://ec.europa.eu/info/law/better-regulation/initiative/113085/attachment/090166e5b5347354_en)

[2] European Commission Communication: Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment, 20 September 2017, available from [http://ec.europa.eu/finance/docs/law/170920-communication-esas\\_en.pdf](http://ec.europa.eu/finance/docs/law/170920-communication-esas_en.pdf)

[3] The package of measures also included proposals concerning the ESRB, Solvency II and EMIR II, available from [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision\\_en#reviewoftheesfs](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en#reviewoftheesfs)

[4] Proposed ESA Regulation, available from [https://ec.europa.eu/info/law/better-regulation/initiative/113085/attachment/090166e5b5347354\\_en](https://ec.europa.eu/info/law/better-regulation/initiative/113085/attachment/090166e5b5347354_en)

[5] Memo 30697, RE: EU Commission Consultation on the Operation of the European Supervisory Authorities - Draft ICI Global Response, dated 10 May 2017, available from <https://www.iciglobal.org/iciglobal/pubs/memos/memo30697>

[6] Memo 30759, RE: EU Commission Consultation on the Operation of the European Supervisory Authorities - ICI Global Response, dated 29 June 2017, available from <https://www.iciglobal.org/iciglobal/pubs/memos/memo30759>

[7] Recital 18, proposed ESA Regulation

[8] Recital 18, proposed ESA Regulation

[9] Article 31a(2), proposed ESA Regulation

[10] Article 5(4), UCITS Directive requires the management company or, where applicable, the investment company, shall be informed, within two months of the submission of a complete application, whether or not authorisation of the UCITS has been granted.

[11] Article 8(5), AIFM Directive requires an applicant to be informed in writing within 3 months of the submission of a complete application, whether or not authorisation has been granted as an AIFM.

[12] Certain exemptions are proposed from the requirement to publication the recommendation and reasons for non-compliance (e.g. if is in conflict with the legitimate interest of those financial institutions or with the protection of their business secrets or could seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system of the Union), see Article 39 amendments, ESA, Proposed ESA Regulation.

[13] Article 17(4), ESMA Regulation provides competency for the Commission to issue to a formal opinion requiring an NCA to take the action necessary to comply with Union law.

[14] Article 17(3), ESMA Regulation requires NCAs to inform ESMA of the steps it has taken or intends to take to ensure compliance with Union law within 10 working days. The proposed ESMA Regulation envisages that where a NCA does not follow ESMA recommendation within 15 working days, the NCA shall state the reasons and ESMA shall make its recommendation public together with those reasons.

[15] Article 31a(3), proposed ESA Regulation

[16] See fn11, for a summary of the exemptions from publication.

[17] Article 29a, proposed ESA Regulation

[18] Article 4, 5, 7, 14c and 20a, proposed ESA Regulation

[19] Article 4, 5, 7, 15c, 19 and 21a, proposed ESA Regulation

[20] Article 4, 5, 7, 6a, 31, 32, 34, 35, 35a, 35g and 36b, proposed ESA Regulation

[21] Article 3(2), AIFM Directive specifies thresholds of EUR100mn or EUR500mn, subject to certain conditions.

[22] page 27, Explanatory Statement, proposed ESA Regulation

[23] Article 6, proposed ESA Regulation

[24] Article 8, 20, 33, 48b, 48i, 48m and 48o, proposed ESA Regulation

[25] Article 7, 9, 21, 22, 28, 29, 31a, 31b, 38n, 43i,

[26] The Commission has published a separate proposed Regulation concerning CCPs, available at [https://ec.europa.eu/info/law/better-regulation/initiative/113034/attachment/090166e5b5344dfa\\_en](https://ec.europa.eu/info/law/better-regulation/initiative/113034/attachment/090166e5b5344dfa_en)

[27] Recital 38, 39 and Article 6, proposed ESA Regulation

[28] Article 35b, proposed ESA Regulation

[29] Under the proposal, the Board of Supervisors, comprised of chairpersons and heads of NCAs and members of the Executive Board, will be reconstituted and take decisions by

simple majority or, in the case of regulatory decisions, by qualified majority voting (QMV).

[\[30\]](#) Article 47, proposed ESA Regulation

[\[31\]](#) Article 45(2), proposed ESA Regulation

[\[32\]](#) Article 46, proposed ESA Regulation

[\[33\]](#) Article 63, 64 and 49a, proposed ESA Regulation

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